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C O N F I D E N T I A L SECTION 01 OF 03 CARACAS 003559

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ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD
NSC FOR DTOMLINSON

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TAGS: [ECON](#) [ENRG](#) [EPET](#) [EINV](#) [VE](#)

SUBJECT: MIXED BAG FOR SERVICE COMPANIES

REF: CARACAS 03402

Classified By: Economic Counselor Andrew N. Bowen for Reason 1.4 (D)

11. (C) SUMMARY: Service company representatives in western Venezuela present a mixed picture when it comes to dealing with PDVSA. Companies that provide services report payment problems and administrative arrangements straight from the pages of Kafka. However, equipment companies frequently benefit from PDVSA managers' lack of sophistication. PDVSA also appears to be somewhat lax in forcing some service companies to meet new social development obligations. END SUMMARY

STRAIGHT OUT OF KAFKA

12. (C) Petroleum Attache (Petatt) met with senior executives from Wood Group's gas turbine unit, Simco (a consortium that provides water treatment services in which Wood Group holds a 50 percent stake), and Baker Oil Tools on December 4-5 to discuss the operational environment in western Venezuela. Based on the conversations, it appears that service providers face a myriad of administrative and payment problems, but equipment providers are benefiting from PDVSA managers' relative incompetence and inexperience.

13. (C) The Simco executive complained the consortium had not been paid for months. When he presented a bill to PDVSA, he was told that only entities registered as companies that promote social production companies (REPS) could receive payments. When he went to register Simco as a REPS, he was told that consortiums could not register as REPS, only companies could do so. The executive stated that one of the consortium members was close to PDVSA management and he was hoping that the matter would be resolved in the near future.

14. (C) The executive also complained that earlier PDVSA officials told him that they were deducting an amount equal

to five percent of his contract's gross revenues for social development purposes. When the executive pointed out that his contract was signed in 1997 and should be exempt from the new requirements, the PDVSA officials told him that it did not matter. PDVSA relented when the executive told them that the consortium could no longer provide it with services due to the fact that the contract was no longer profitable with the new social development deductions. The executive also stated the consortium has had multiple problems with tax authorities.

15. (C) An additional source of frustration is a lack of competence among PDVSA managers. The number of wells that Simco is servicing has dropped dramatically due to lack of maintenance. The executive stated that wells have detailed, comprehensive maintenance records up until 2003. After that date, maintenance records are practically nonexistent. As wells clog up due to a lack of maintenance, PDVSA officials simply close them rather than attempting to maintain them.

16. (C) PDVSA's lack of competence extends to the utilization of assets. Simco supplied a series of platforms to PDVSA under the BOOT system (Build, Own, Operate, Transfer). Under the contract, Simco operates the platform for sixteen years and then transfers ownership to PDVSA. According to the executive, one of the platforms is currently idle. The executive stated he has repeatedly urged PDVSA to move the platform and utilize it in another area. Despite the fact that they are spending significant sums for the platform, PDVSA officials are unwilling to move it. The executive opined that PDVSA no longer has qualified staff to carry out the necessary engineering studies to reposition the platform.

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PLEASE TAKE MY MONEY

17. (C) Service companies that provide equipment, on the other hand, appear to be benefiting from PDVSA management's lack of expertise as well as the need to maintain production. A Wood Group gas turbine executive said PDVSA managers' demand for gas turbines appears to be inelastic. Their basic attitude is "Just tell me how much it costs". In one case, a PDVSA manager forgot to consider installation costs when ordering the equipment. When the Wood executive asked about installation, the manager told him that Wood Group should install the equipment and send PDVSA the bill. The manager made no effort to negotiate the price for installation. The Wood Group executive also stated PDVSA frequently requests consulting services for the gas turbines due to a lack of operating expertise.

18. (C) Perhaps the most egregious example of PDVSA naivete according to the Wood Group executive was the recent purchase of engine covers. The Wood Group executive asked a PDVSA manager if he needed covers for two engines. The manager replied he did not since he had just ordered the covers from Italy. The Wood Group executive described the covers as simple metalworking jobs. Without thinking, the executive asked the PDVSA official what in the world he was thinking and then realized that he may have pushed the official too hard. The PDVSA official replied that he ordered the covers from Italy since the motors were originally from Italy. The Wood Group executive quickly agreed that it was a good idea in order to maintain a good working relationship.

19. (C) Although Baker Oil Tools has not had quite the same experience as the Wood Group executive, a senior Baker executive told Petatt that his company recently had some payment problems with PDVSA production in Maracaibo. When the Baker executive threatened to cancel the contract, the production manager begged him to reconsider and promised to do everything in his power to resolve the situation. The Baker Oil Tools executive was shocked, since the standard PDVSA response in the past has been to dare the company to

stop supplying it.

TRENDS

¶10. (C) Both the Wood Group gas turbine executive and the Baker Oil Tool executives stated they have seen changes in customers' behavior recently. The Baker executives stated they have not seen a sharp increase in equipment orders from PDVSA despite its claims that it is embarking on a major investment drive in western Venezuela. However, the executives stated PDVSA is purchasing electric submersible pumps for Lake Maracaibo as it replaces existing units. The executives attributed this to the gas shortage in western Venezuela. They also noted that there has been a noticeable slowdown in operations by Repsol and Petrobras. According to one of the executives, Repsol is no longer focused on gas projects but rather electricity generation. The executive also stated Baker Oil Tools has seen very little activity on the major gas projects in Venezuela. Finally, the executives noted their direct competitors have begun importing certain types of oil tools into Venezuela since it is cheaper than producing them locally.

¶11. (C) The Wood Group executive stated none of his customers from outside Venezuela, including companies operating in Trinidad and Tobago, are sending their motors to the Maracaibo complex for reworking or overhaul. They now prefer to send the units to Houston. The executive was not clear on

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why this was happening but stated it was good for Wood Group due to Venezuela's artificially high, fixed exchange rate.

DON'T DO AS I SAY OR DO

¶12. (C) Despite PDVSA's frequent posturing on social development, the Baker Oil Tool executives stated they have seen very little actual movement. When Baker Hughes attempted to set up a cooperative to provide down hole services, PDVSA quickly squashed the move due to concerns over liability. In addition, Baker Oil Tools has only seen two contracts that contain language requiring a one to three percent social contribution. The executive stated PDVSA to date has not attempted to charge it the social contribution.

¶13. (C) The Baker executives also stated they recently backed out of a bid due to liability concerns over the social development project that was attached to the bid. The project was a water delivery system for a village and included the construction of a water tank. Both Weatherford and Smith also dropped out of the bid due to liability concerns. Local Venezuelan companies, however, did not drop out.

COMMENT

¶14. (C) It appears at this point that service companies are taking a "wait and see" attitude toward Venezuela. None of them is sure how seriously to take the BRV's proposal to migrate some or all service companies to joint ventures (Reftel). In addition, rumors have recently surfaced that PDVSA will undergo a thorough housecleaning. Hugo Hernandez Rafalli, a former PDVSA director with close ties to senior BRV and PDVSA officials, told Petatt on December 4 that there will be a major shakeup at the Ministry of Energy and PDVSA in February. He also thought that President Chavez was serious about rooting out corruption. In addition, one of the Baker Oil Tools executives claimed former PDVSA employees who lost their jobs during the strike were going to receive settlements for lost wages and pension contributions as well as offers to rejoin PDVSA. The executive viewed the rumor as credible since he believes PDVSA management is well aware of the company's many operational and administrative

shortcomings. We do not expect any major changes in the service companies' operations until they have a clearer picture of the Venezuelan investment climate.

WHITAKER